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MEMORANDUM

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FROM: Steve Olea
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Utilities Division

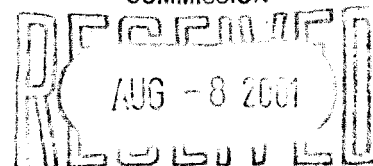
Date: August 2, 2001

RE: ICR WATER USERS ASSOCIATION, INC., APPLICATION FOR AN
EXTENSION OF ITS CERTIFICATE OF CONVENIENCE AND NECESSITY
(CC&N) TO PROVIDE WATER SERVICE IN YAVAPAI COUNTY,
ARIZONA. DOCKET NO. W-02824A-01-0450

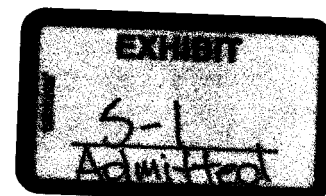
Attached is the Staff Report for the above referenced application. Staff is recommending approval of the application following a hearing.

Originator: Jim Fisher

Attachment: Original and Eleven Copies

ARIZONA CORPORATION
COMMISSION

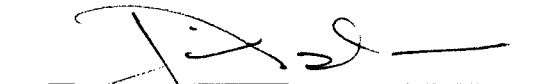
Director of Utilities




STAFF ACKNOWLEDGEMENT

The Staff members designated below contributed elements of this Staff Report.

Contributing Staff:



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Marlin Scott
Utilities Engineer

STAFF REPORT
UTILITIES DIVISION
ARIZONA CORPORATION COMMISSION

ICR WATER USERS ASSOCIATION, INC.
DOCKET NO W-02824A-01-0450

APPLICATION FOR AN EXTENSION OF CERTIFICATE OF CONVENIENCE AND
NECESSITY (CC&N) TO PROVIDE WATER SERVICE IN YAVAPAI COUNTY, ARIZONA

August 2001

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Introduction

On May 31, 2001, ICR Water Users Association, Inc., an Arizona corporation, ("ICR"), filed an application with the Arizona Corporation Commission ("ACC") requesting approval for an extension of its existing Certificate of Convenience and Necessity, ("CC&N") in Yavapai County, Arizona. On June 7, 2001, Harvard Simon, the property owner requesting ICR to extend service filed for intervention in the application. On July 19, 2001, ICR provided additional information on the application. On July 26, 2001, ICR filed the First Amendment to its Application. On August 1, 2001, Harvard Simon provided Staff with a copy of a Water Purchase Agreement.

Background

ICR is an Arizona corporation engaged in providing water utility service within portions of Yavapai County, Arizona. The Company was granted its initial CC&N on August 30, 1995, in Decision No. 59263. The Company currently has seventy-one (71) customers.

By this application, ICR is seeking to extend its current CC&N to include an additional 3,070 acres. ICR was requested by the property owner, Harvard Simon I, L.L.C. ("Harvard") to extend services to the adjacent property. ICR estimates the first year of service to the extended area will bring fifty additional customers, with an additional one hundred twenty-five customers per year for each of the following five (5) years.

Harvard has requested service for its planned development, Talking Rock Ranch, a residential subdivision containing approximately one thousand five hundred (1,500) residential dwellings. The development will also include common areas, clubhouse, swimming pool, fitness center and an eighteen-hole golf course, with storage lakes.

On March 5, 2001, ICR and Harvard entered into a main extension agreement (Exhibit 1 to the Application) requiring Harvard to advance all of the required facilities to ICR. Harvard has agreed that all facilities will be constructed in strict conformance with submitted and approved plans to the Arizona Department of Environmental Quality ("ADEQ") or Yavapai County Environmental Services Department ("YCESD"). ICR has all rights to inspection and testing. Harvard is required to convey the facilities via a bill of sale, with permanent easements and rights-of-way. ICR will issue a letter of acceptance to Harvard upon transfer of the facilities.

The main extension agreement requires ICR to refund to Harvard fifteen (15) percent of the gross annual operating revenues from water sales to customers in the extension property for a period of twenty-five (25) years. Any unpaid balance at the end of the twenty-five (25) year period will become a non-refundable contribution-in-aid-of-construction to ICR.

Attached to the main extension agreement is a May 22, 2000, estimate of facilities including two wells, two 1,000,000 gallon storage tanks, transmission and distribution facilities estimated to cost in excess of \$15,398,078.

ICR obtained a county franchise for a portion of the requested area and submitted a copy of it as Exhibit 7 to the Application. ICR has agreed to obtain a county franchise for the remaining property.

According to Harvard's June 7, 2001, Motion to Intervene, the development is "on hold, pending, at a minimum, the Commission's Staff report." According to Harvard, the Arizona Department of Water Resources ("ADWR") will not issue a water adequacy report, "until a Staff report is issued recommending approval of ICR's application." Harvard further represents that "ADWR acknowledges that Harvard's hydrology study is correct and that adequate physical availability has been proven," however, final approval will not be granted pending action by the ACC.

Harvard also informed the ACC that "the parties have also entered into a Water Purchase Agreement whereby Harvard will be providing water to ICR at costs lower than the utility's current cost of water." This agreement was not included in the application nor referenced in the associated main extension agreement.

On August 1, 2001, Harvard provided Staff with a copy of the April 27, 2001, Water Purchase Agreement between ICR and Harvard. Harvard has drilled a well in the proposed extension territory and has entered into an agreement with ICR to sell water to ICR at \$0.15 per 1,000 gallons, for resale to the ICR customers in Harvard's development. This Agreement was not submitted for approval in this application. Staff's recommendation for approval of this CC&N extension application does not imply a recommendation for any particular future treatment for ICR's authorized expenses. No "used and useful" or "prudent investment" review was requested or made, and no conclusions should be inferred for ratemaking purposes.

ICR's Existing Water System

According to ICR's 2000 Annual Report, ICR has a water system consisting of a well, storage tank, booster system and a distribution system serving 67 customers. This system has one operating well having a capacity of 225 gallons per minute ("GPM"), a 110,000 gallon storage tank, three 20 horsepower (Hp) booster pumps, a 3,200 gallon pressure tank, and a distribution system consisting of 72,400 feet of main with 32 fire hydrants. The filed application indicated the customer base was now at 71.

Arizona Department of Environmental Quality Compliance

ICR has no major deficiencies and the ADEQ has determined that this system, PWS # 13-303 is currently delivering water that meets water quality standards required by Arizona Administrative Code, Title 18, Chapter 4. ICR stated it would provide the Certificate of Approval to Construct with the submittal of a main extension agreement.

Arizona Department of Water Resources Compliance

ICR's existing system is just outside the western boundary of the Prescott Active Management Area. The requested 4-1/2 square miles of extension areas is also just outside the

western boundary. Since ICR is not located in this Prescott AMA, ICR should be required to obtain an Adequate Water Supply Certificate for this proceeding.

Proposed Plant for Requested Area

ICR submitted a plant listing of facilities to be constructed for the requested area as shown in Table A. These facilities will be financed primarily by advances in aid of construction via a main extension agreement, which will be submitted to Staff for approval.

Table A

Talking Rock Ranch Project					
Water Facilities	Quantity	Unit	Unit Price	Amount	
12-inch DIP	11,932	l.f.	\$55	\$656,260	
12-inch Gate valve & box	16	ea.	\$2,275	\$36,400	
10-inch PVC Pipe	76,850	l.f.	\$46	\$3,535,100	
10-inch Gate valve & box	149	ea.	\$2,075	\$309,175	
8-inch PVC Pipe	100,991	l.f.	\$48	\$4,847,568	
8-inch Gate valve & box	207	ea.	\$1,075	\$222,525	
6-inch PVC Pipe	54,460	l.f.	\$42	\$2,287,320	
6-inch Gate valve & box	66	ea.	\$875	\$57,750	
6-inch Fire hydrants	323	ea.	\$2,500	\$807,500	
1-inch Service	1,660	ea.	\$500	\$830,000	
Air Release Station	274	ea.	\$1,500	\$411,000	
Blow-offs	174	ea.	\$500	\$87,000	
Pump Station- High pressure zone	1	l.s.	\$230,000	\$230,000	
Booster pump station	1	ea.	\$125,000	\$125,000	
Misc. fittings @ 5%	1	l.s.	\$637,980	\$637,980	
300,000 gallon storage tank	600,000	gal.	\$0.30	\$180,000	
Well, 525 gpm	1	l.s.	n/a	n/a	
TOTAL:				\$15,260,578	

According to Staff Engineering, the listed plant facilities' cost estimates appear to be very high and will be evaluated during the main extension agreement review.

The current well capacity of 225 GPM and storage capacity of 110,000 gallons could adequately serve up to 149 connections with fire flow protection. The Company currently serves approximately 71 connections.

The proposed plant facilities will increase the well capacity to 750 GPM and storage capacity to 710,000 gallons. These increased plant capacities would serve up to 1,268 connections.

Staff's recommendation for approval of this CC&N extension application and its submitted plant facilities in Table A does not imply a recommendation for any particular future treatment for ICR's rate base. No "used and useful" determination of the proposed plant facilities was made, and no conclusions should be inferred for ratemaking or rate base purposes.

Proposed Rates

ICR has agreed to extend service to the property at its tariffed rates. ICR is currently a small water association. This proposed extension, and the related facilities construction agreement will result in a relatively large amount of plant being conveyed to the association. While the association will receive the facilities on a date certain, the customers to be served by the facilities will begin taking service over an extended period of time. Such a situation can result in a mismatch between the facilities needed to serve existing customers and the revenues generated to fully support the utility.

For example, in year one, ICR projects revenue of \$43,469 and expenses of \$71,913. In year three, ICR estimates revenue of \$156,198 with expenses of \$190,392 and in year five, revenue of \$281,599 with expenses projected at \$323,388.

On July 19, 2001, ICR provided additional detail on the projected revenues and expenses associated with the extension territory. On July 26, 2001, ICR filed an Amendment its Application to clarify projected operating expenses. ICR has provided estimated income and cash flow statements to demonstrate ICR's cash flow will be sufficient during build out of the extension area. According to the Company, projected expenses associated with the extension are primarily non-cash depreciation expenses related to the facilities advanced by the developer.

According to ICR's Projected Statements of Income, year one total operating expenses are to be \$71,913, with depreciation expense projected to be \$39,934, resulting in year one estimated cash flow of \$11,732. In year three, ICR projects depreciation expense of \$91,742 and operating expenses of \$128,119, resulting in cash flow for the same period of \$60,042. In the fifth year, ICR projects depreciation expenses to be \$144,824 of the total projected operating expenses of \$212,743. ICR estimates cash flow for the same period to be \$109,529.

In addition, according to ICR's Projection of Cash Flow schedules, year one ending cash balances are estimated to be \$12,870. In years three and five, ICR estimates ending cash balances of \$93,125 and \$220,738 respectively.

ICR has no current long-term debt service requirements. ICR has provided projected cash flow statements that show that cash generated should be sufficient to cover any financial contingencies.

As a result of the proposed transactions discussed above, ICR will be increasing plant, revenue, expenses, and customers. ICR currently serves 71 customers, with rates that were established in 1995. Staff recommends the Company be required to file a rate application no later than five years from the effective date of the Commission's decision in this matter.

Recommendations

Staff recommends that the Commission grant the ICR Water Users Association, Inc., application for an Extension to its Certificate of Convenience and Necessity to provide water service, subject to compliance with the following conditions:

Staff recommends that the Commission require the ICR Water Users Association, Inc., to file with the Director of the Utilities Division, a copy of the Arizona Department of Water Resources findings that the developer has demonstrated an adequate physical availability of water to serve the extension area, within 365 days from the effective date of the Commission's Decision.

Staff recommends that the Commission require the ICR Water Users Association, Inc., to file with the Director of the Utilities Division, the Arizona Department of Environmental Quality approvals for construction of all water facilities, with the appropriate main extension agreement, or within 365 days from the effective date of the Commission's Decision, which ever is sooner.

Staff further recommends that the Commission require ICR Water Users Association, Inc., to file a rate application for water service no later than five years from the effective date of the Commission's Decision in this matter.

Staff further recommends that the Commission's Decision granting this Extension to a Certificate of Convenience and Necessity to the ICR Water Users Association, Inc be considered null and void without further order from the Commission should ICR Water Users Association, Inc., fail to meet any of the above conditions within the time specified.

Staff further recommends that the ICR Water Users Association, Inc., charge its existing rates in this extension area.